

- HIGHLIGHTS

- Provide for a safe and sound system of financial institutions and help put them in a position to contribute to economic progress by strengthening and updating the department's salary and personnel classification structure.
- Work with other state and federal regulators to determine what regulatory burden could be reduced for community based depository institutions as we continue to establish appropriate safety and soundness standards. We are now working with a national committee of state regulators to look at that issue while we continue to review internal department processes and procedures in working with federal agencies.
- Employ "Lean Government" principles to make department processes more efficient and effective.
- Establish a risk focused regulatory program for non-bank financial institutions that differentiates regulatory scrutiny based on compliance benchmarks.

INTRODUCTION

The Department of Financial Institutions (TDFI) regulates approximately 10,000 institutions and individuals providing financial services in Tennessee including banks, credit unions, trust companies, business and industrial development corporations, finance companies, check cashers, payday lenders, title pledge lenders, money transmitters and mortgage lenders, brokers, servicers and originators.

The department's mission is to provide the people of Tennessee with a safe and sound system of banks and other institutions by ensuring safety and soundness and compliance with governing law, while giving institutions the opportunity to contribute to the economic progress of Tennessee and the nation.

The department carries out this mission through four basic functions. Through various types of applications,

the department determines the appropriateness of a variety of activities and makes judgments as to who can engage in certain financial services in Tennessee. Through examinations, the department gauges the safety and soundness of institutions and whether there is compliance with governing law. By means of formal and informal actions, the department provides guidance or direction to institutions that may have issues to resolve. Finally, the department is an outlet for consumers to contact to seek help and information.

APPROACH/METHODOLOGY

The Top to Bottom Review examined the department's mission, statutory responsibilities, operational environment and structure to determine how the mission can be more efficiently and effectively met.

Each division head was tasked with coordinating discussions with staff, and the commissioner met with staff, including examiners in the field. The commissioner also met with industry members to solicit comment. Federal law and process plays a significant role in the day-to-day regulatory operations of the department. Comments and suggestions on issues primarily affected by the federal government were encouraged and general discussions were also held with some federal regulatory agencies.

The following basic questions were raised:

- 1. Is our mission sound?
- 2. Are we engaged in activities designed to meet our mission?
- 3. Are we engaged in activities that distract us?
- 4. How can we meet our mission more effectively, while reducing cost?
- 5. What challenges are we likely to face?

RECOMMENDATIONS

Recommendation 1: Provide for a safe and sound system of financial institutions and help put them in a position to contribute to economic progress by strengthening and updating the department's salary and personnel classification structure.

Discussion: The fundamental mission of the department is to provide a safe and sound system of financial institutions which is critical to the economic development of Tennessee. Financial institutions are facing serious challenges in the current environment. The combination of an extended economic downturn coupled with additional federal regulation may strain institutions as well as the communities they serve. We believe that the establishment of an equal partnership between the department and federal regulatory agencies presents the best environment for financial institutions to be successful. That equal partnership is best promoted by a stable and experienced team of examiners. In recent years, the department has lost some key staff to federal agencies and the industry.

Updating staff salaries and classifications will help strengthen regulatory experience which in turn supports the department's ability to make the proper safety and soundness decisions. It is this regulatory balance that should assist financial institutions and the communities they serve in supporting a recovering Tennessee economy. In working with the departments of Human Resources and Finance and Administration, the TDFI has been able to begin the process of updating staff salaries primarily funded through savings generated by the department over the last year. The department is fully funded by the institutions it regulates and does not use taxpayer money.

Recommendation 2: Work with other state and federal regulators to determine what regulatory burden could be reduced for community based depository institutions as we continue to establish appropriate safety and soundness standards.

Discussion: Community based institutions are challenged in the current environment. It is critical that states support these institutions from an economic development standpoint. For instance, it has been suggested that a separate tier of regulation be established for smaller community banks in recognition that the business model works and should be preserved as a key component of the nation's economy. The primary objective is to work with local and regional offices of the Federal Deposit Insurance Corporation, National Credit Union Administration and the Federal Reserve to achieve more tailored application of regulatory standards and to work with the Conference of State Bank Supervisors and the National Association of State Credit Union Supervisors to determine if changes can be made to national standards to support community based institutions. This work is underway now and will be influenced as federal policy continues to develop and evolve in the wake of the federal Dodd-Frank law.

Recommendation 3: Hire additional bank safety and soundness administrators in order to strengthen the turnaround time on sending examination reports to bank boards.

Discussion: This should make a significant impact on processing bank examinations and reduce the time it takes to get this information to bank boards. It is critical in this current environment that bank examination reports and the guidance and conclusions they contain be delivered more timely to bank management. Additional staff has been hired as of January 2012 and the effect upon the turnaround time will continue to be measured going forward.

Recommendation 4: Employ LEAN management principles to make department processes more efficient and effective.

Discussion: In many respects, this effort to review and improve individual department processes will be a foundation for the department's efforts to maintain a safe and sound system of financial institutions in Tennessee. Simpler and more streamlined process and procedures should make it easier for financial institutions and their customers to do business in Tennessee. Moreover, the department continues to look for cost savings that can help support updated salaries and personnel classifications. In February 2012, the department will be one of the first state agencies to carry out a LEAN event when it reviews a licensing function. Other areas are under consideration.

Recommendation 5: Issue state vehicles for department examiners to replace the use of examiner owned vehicles.

Discussion: This recommendation was identified early on in working with the Department of General Services. This effort is estimated to generate approximately \$100,000 in savings on an annual basis which will support the recommendation of strengthening department salaries and classifications.

This recommendation has been completed.

Recommendation 6: Review the department's non-bank examiner work force to right size it to the economic realities of the regulated industry.

Discussion: In recent years, the regulated non-bank mortgage industry has lost well over half of the licensees that previously operated in Tennessee. In recognition of this marketplace reality, the department undertook a Reduction in Force in 2011. Along with vacant positions, the total number of positions eliminated pursuant to this review totaled 10. The department will periodically review this area to determine the examiner work force needs based on the realities of the marketplace.

Recommendation 7: Review department field office space to maximize efficiency.

Discussion: This recommendation was identified early on as part of the cost savings efforts in the department. In January, 2012, the department closed its Cordova field office which will generate savings of approximately \$65,000 on an annual basis. This action primarily was taken in response to the review under Recommendation 6. Additional consolidation is currently under review.

Recommendation 8: Establish a risk focused regulatory program for non-bank financial institutions that differentiates regulatory scrutiny based on compliance benchmarks.

Discussion: The department has worked for many years to establish regulatory programs for non-bank financial institutions. A logical next step would be to establish specific compliance benchmarks to determine the risk profile of licensees. By doing so, more regulatory attention could be placed on those licensees posing greater risk to the public and less regulatory burden could be placed on those licensees that are meeting regulatory expectations.